



# DEPARTMENT OF THE TREASURY

Internal Revenue Service  
TE/GE EO Examinations  
1100 Commerce Street  
Dallas, TX 75424

501-03-00

**TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION**

December 9, 2009

Release Number: **201013061**  
Release Date: 4/2/10

**LEGEND**

ORG = ORGANIZATION NAME      XX = DATE      ADDRESS = ADDRESS

ORG  
ADDRESS

Person to Contact:  
Identification Number:  
Contact Telephone Number:  
In Reply Refer to: TE/GE Review Staff  
EIN:

**CERTIFIED MAIL – RETURN RECEIPT**

LAST DATE FOR FILING A PETITION  
WITH THE TAX COURT: **March 9, 20XX**

Dear

This is a Final Adverse Determination Letter as to your exempt status under section 501(c)(3) of the Internal Revenue Code. Your exemption from Federal income tax under section 501(c)(3) of the code is hereby revoked effective January 1, 20XX.

Our adverse determination was made for the following reasons:

To be exempt under IRC section 501(c)(3), an organization must be organized and operated exclusively for charitable, educational, or other exempt purposes. Your activity of selling and administering debt management plans demonstrated that you had a more than insubstantial non-exempt commercial purpose. Your activities to further educational or charitable purposes were incidental in comparison to your overall operations. In addition, some of your net earnings, inured to private shareholders or individuals of your organization through your payment of their automobile, travel and entertainment, and other expenses.

Contributions to your organization are no longer deductible under section 170 of the Internal Revenue Code. You are required to file Federal income tax returns on Form 1120. These returns should be filed with the appropriate Service Center for the year ending December 31, 20XX, and for all years thereafter.

Processing of income tax returns and assessment of any taxes due will not be delayed should a petition for declaratory judgment be filed under section 7428 of the Internal Revenue Code.

You also have the right to contact the office of the Taxpayer Advocate. However, you should first contact the person whose name and telephone number are shown above since this person can access your tax information and can help you get answers.

You can call and ask for Taxpayer Advocate assistance. Or you can contact the Taxpayer Advocate from the site where the tax deficiency was determined by calling, or writing:

Taxpayer Advocate assistance cannot be used as a substitute for established IRS procedures, formal appeals processes, etc. The Taxpayer Advocate is not able to reverse legal or technically correct tax determinations, nor extend the time fixed by law that you have to file a petition in the United States Tax Court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling.

We will notify the appropriate State Officials of this action, as required by section 6104(c) of the Internal Revenue Code.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely yours,

Nanette M. Downing  
Acting Director, EO  
Examinations

**Internal Revenue Service**

**Department of the Treasury**  
TE/GE Div. EO Group 7983  
9350 Flair Dr. 2nd Floor  
El Monte, CA 91731-2885

Date: November 24, 2008

ORG  
ADDRESS  
CITY, STATE

Taxpayer Identification Number:

Form:

Tax Year(s) Ended:

Person to Contact/ID Number:

Contact Numbers:

Telephone:

Fax:

**Certified Mail - Return Receipt Requested**

Dear

We have enclosed a copy of our report of examination explaining why we believe revocation of your exempt status under section 501(c)(3) of the Internal Revenue Code (Code) is necessary.

If you accept our findings, take no further action. We will issue a final revocation letter.

If you do not agree with our proposed revocation, you must submit to us a written request for Appeals Office consideration within 30 days from the date of this letter to protest our decision. Your protest should include a statement of the facts, the applicable law, and arguments in support of your position.

An Appeals officer will review your case. The Appeals office is independent of the Director, EO Examinations. The Appeals Office resolves most disputes informally and promptly. The enclosed Publication 3498, *The Examination Process*, and Publication 892, *Exempt Organizations Appeal Procedures for Unagreed Issues*, explain how to appeal an Internal Revenue Service (IRS) decision. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process.

You may also request that we refer this matter for technical advice as explained in Publication 892. If we issue a determination letter to you based on technical advice, no further administrative appeal is available to you within the IRS regarding the issue that was the subject of the technical advice.

If we do not hear from you within 30 days from the date of this letter, we will process your case based on the recommendations shown in the report of examination. If you do not protest this proposed determination within 30 days from the date of this letter, the IRS will consider it to be a failure to exhaust your available administrative remedies. Section 7428(b)(2) of the Code provides, in part: "A declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the Claims Court, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted its administrative remedies within the Internal Revenue Service." We will then issue a final revocation letter. We will also notify the appropriate state officials of the revocation in accordance with section 6104(c) of the Code.

You have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free 1-877-777-4778 and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

If you have any questions, please call the contact person at the telephone number shown in the heading of this letter. If you write, please provide a telephone number and the most convenient time to call if we need to contact you.

Thank you for your cooperation.

Sincerely,

Vicki L Hansen  
Director, EO Examinations

Enclosures:  
Publication 892  
Publication 3498  
Report of Examination

Form <b>886A</b>	Department of the Treasury - Internal Revenue Service <b>Explanation of Items</b>	Schedule No. or Exhibit
Name of Taxpayer  ORG, EIN		Year/Period Ended 12/31/20XX, 12/31/20XX

**LEGEND**

ORG = Organization name      XX = Date      City = city      State = state  
Address = address      President = president      Secretary = secretary      DIR-1, DIR-2 & DIR-3 = 1<sup>st</sup> Director, 2<sup>nd</sup> Director & 3<sup>rd</sup> Director      CFO = CFO  
CFO-1 = CFO-1      EMP-1 & EMP-2 = 1<sup>st</sup> & 2<sup>nd</sup> Employee      Bank-1 & Bank-2 = 1<sup>st</sup> & 2<sup>nd</sup> Bank      Trust = trust      CO-1, CO-2 & Co-3 = 1<sup>st</sup> Company, 2<sup>nd</sup> Company & 3<sup>rd</sup> Company

**Issue:**

Whether ORG (ORG) was operated exclusively for exempt purposes described within Internal Revenue Code section 501(c)(3):

- a. Whether ORG is engaged primarily in activities that accomplish an exempt purpose?
- b. Whether more than an insubstantial part of ORG's activities is in furtherance of a non-exempt purpose?

**Facts**

**Background of ORG:**

ORG (ORG), with Employer Identification Number ("EIN") #, was initially incorporated in the State of State under the name of ORG Service on March 20, 19XX. The specific purpose of the corporation was to negotiate the debts of clients with their creditors and provide guidance. On July 27, 19XX, ORG's Article II of its Articles of Incorporation was amended to read as follows:

"A. This corporation is a non profit public benefit corporation and is not organized for the private gain of any person. It is organized under the non profit Public Benefit corporation Law for charitable and educational purposes.

B. The specific purpose for which this corporation is organized is to negotiate the debts of debtors with their creditors and provide education and guidance for debtors in the handling of credit and payment on debt.

...."

On February 25, 19XX, ORG amended its name to ORG.

ORG filed Form 1023, *Application for Recognition of Exemption under Section 501(c)(3) of the Internal Revenue Code*, as a private foundation. The application was signed by President as president of ORG. ORG described its activities and operational information on page 2 of Form 1023 as and hereby quoted:

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“Purpose of Foundation is to negotiate the debts of clients at -0- interest rate, funds will be deposited in trust account, to process payments of clients to pay creditors. Main purpose is to save money to clients and speed the payment time. Documentation is obtained to be able to negotiate with creditors. Activity will be conducted by ORG Service at Address, City, State.”

The officers listed on the Form 1023 were President as President, Secretary as Secretary, and Treasurer as Treasurer. ORG adopted its bylaws on July 27, 19XX. On January 5, 19XX, the Service recognized ORG as an Internal Revenue Code section 501(c)(4) organization. The determination exemption letter was issued to ORG under the name of ORG Services. On March 20, 20XX, the Service issued another exemption letter to ORG as a Private Operating Foundation as in Internal Revenue Code section 4942(j)(3).

### **Minutes:**

During the years under examination, ORG provided several unanimous written consents of the board of directors adopting resolutions. On the Unanimous Written Consent of the Board of Directors of ORG in lieu of Annual Meeting dated July 28, 20XX, the board elected the following persons as Directors of the Corporation: Secretary, DIR-1, DIR-2 and DIR-3. The board also elected the following persons as officers: Secretary as President, CFO as Chief Financial Officer and Secretary.

On May 31, 20XX, the board adopted seven unanimous written consents.

One of the seven unanimous written consents indicated Secretary has resigned as President of the Corporation. Another unanimous written consent indicated Secretary has resigned as Director of the Corporation. The third of the seven unanimous written consents indicated the Corporation hired Secretary as a consultant for \$ per month to perform services for the Corporation as directed by the President of the Corporation.

Another unanimous written consent indicated CFO as President of the Corporation and CFO-1 as Chief Financial Officer and Secretary of the Corporation. ORG has another unanimous written consent which indicated the Corporation will pay a monthly salary of \$ to CFO as his capacity of President of the Corporation and \$ as a monthly car allowance.

On July 25, 20XX, the board adopted a unanimous written consent to name DIR-2 and DIR-3 as directors of the Corporation. It also named CFO as President and Chief Executive Officer and CFO-1 as Chief Financial Officer and Secretary.

On June 20, 20XX, the board adopted four unanimous written consents indicating CFO has resigned as President and Chief Executive Officer of the Corporation. One of the unanimous written consents adopted Secretary as President and Chief Executive Officer and CFO-1 as Chief Financial Officer and Secretary of the Corporation. Another unanimous written consent

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indicated the Corporation approved a monthly salary of \$ for Secretary as President of the Corporation and a monthly car allowance of \$.

Even though the above unanimous written consents were signed by the board members, all the above unanimous written consents appear to be self-serving. There were no explanations as to why ORG needed to change its presidents back and forth between Secretary and CFO. There was no documentation to substantiate how the monthly salary and car allowance for Secretary or CFO was determined. There were no detailed discussions as to why the board hired Secretary to be the consultant for ORG and how the monthly payments to her were determined. There were no detailed discussions regarding ORG's credit counseling activities and how ORG accomplished its exempt purpose in conducting its daily operations.

**ORG's officers and directors:**

In 20XX, ORG's officers and directors were:

<b>Directors</b>	<b>Officers</b>
Secretary	Secretary, President
DIR-1	CFO, CFO
DIR-2	CFO, Secretary
DIR-3	

In 20XX, ORG's officers and directors were:

<b>Directors</b>	<b>Officers</b>
DIR-2	CFO, President and CEO
DIR-3	CFO-1, CFO and Secretary

In 20XX, ORG's officers and directors were:

<b>Directors</b>	<b>Officers</b>
DIR-2	Secretary, President and CEO
DIR-3	CFO-1, CFO and Secretary

**ORG's employees:**

From the initial interview, Secretary and CFO indicated in the year 20XX that ORG had four counselors, one computer employee, two customer care representatives, one in-house bookkeeper, one office manager, two creditor relation representatives and two officers. However, as of the 20XX year, due to lack of funding from the fair share contributions, ORG has only five employees and one officer- Secretary.



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**ORG's website:**

During the course of the examination, Revenue Agent did Internet search and located ORG's website. ORG's first page is hereby quoted,

““We make your life easier, lowering your monthly payments”  
“Hacemos tu vida mas facil reduciendo tus pagos mensuales”

English      Espanol”

ORG's Home page is hereby quoted,

“Let us help to brighten your Financial Future!  
Call us at

What We Can Do For You:

Reduce and/or eliminate your interest rates and over-limit/late fees

Stop creditor calls

Lower your monthly payments

Make one low monthly payment

Reduce your financial stress

Purchase a home after our program completion”

On the About Us page, it is hereby quoted,

“About Us

ORG is a Non-Profit 501(c)(3) Corporation dedicated to assisting consumers having difficulties with their personal finances.

We offer the most beneficial programs in the industry and provide unique and individual solutions for each client. We structure a Debt Management Plan by negotiating with creditors of unsecured debts to lower payments and reduce and/or eliminate interest rates and late or over-limit fees.

We also educate and assist consumers in developing a budget which will allow them to not only meet their essential living expenses, but also to pay down their consumer debts within three to five years.”

ORG's Mission Statement is hereby quoted,



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“”Assist in resolving consumer’s financial burden that request our services, providing confidential orientation; regardless of race, color, creed, gender, social status or financial position. At the same time we support financial education so that our clients improve their resources management, feasible use of credit and achieve financial discipline””

ORG’s Philosophy is hereby quoted,

“We understand that education is one of the most important tools needed to improve one’s life. For this reason, we donate monies to other Non-profit Foundations for scholarships and projects. We believe that giving back to the community in which we work is an important aspect of being an effective Non-Profit Corporation.”

ORG’s Origins is hereby quoted,

“The majority of funding for *ORG* comes from voluntary contributions from creditors who participate in debt repayment programs established on behalf of their clients.”

ORG’s Education page is hereby quoted,

“Education:

1. Financial Education, Introduction (Book 1)
2. Financial Tips (Book 2)
3. Work Book (Book 3)”

From ORG’s website, it appears ORG’s primary focus is on debt management plan servicing to its potential client or clients. ORG does not provide any other services besides the debt management plan.

### **Debt Management Program:**

ORG provides debt management program services to individuals who have debt problems. ORG enrolled approximately 445 new clients in 20XX and 239 in 20XX based on the Client Reports provided on April 18, 20XX. The number of clients who did not pay any client monthly fees was 7 in 20XX and 4 in 20XX. ORG did not provide the total number of existing clients at the beginning of 20XX year.

ORG provides the “Quality Procedures Manual” that was used for its daily operation. In Procedure QP-4.1.3 and hereby quoted,

“Counseling

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A. Objective

According to what has been established in the Mission, the Corporation offers Credit counseling to its clients with the main objective of:

Revise and counsel consumers that come to ORG looking for solutions to their financial burden. To manage client's accounts since they get enrolled in our Debt Management Program and negotiating these debts with the corresponding creditors until the client successfully completes the Program and pays off each debt.

Give the security the accounts have been administered in a professional way, from when the contract is signed until the Completion letter is issued.”

....

C. Definitions/Symbols/Abbreviations

C.1.- Credit Counseling Account Executive: ORG employee that is certified (or in the process to), dedicated to Client's attention since the Debt Management Agreement is signed until the Debts are paid off; including maintenance and consultation pertaining to client's accounts.

C.2.- Debt Management Program: Program designed by ORG to intercede between the client and the creditor.

....

C.5.- Prospect. A potential Client that was generated from a Lead as a result of Advertisement campaigns or recommendations from other sources.

....

E. Responsibilities

E.1.- Counseling Department Leader is the employee responsible, before the General Manager, to achieve the goals set for the Department, as well as preparation of reports to measure productivity.

E.2.- Credit Counselor Account Executive is the employee responsible to give quality service to the client's account assigned by using and implementing the Debt Management Program.

....

F. Procedure Description

F.1.2 Assign office appointments to Counselor Account Executives. The Credit Counseling Leader is responsible for assigning the Counselor Account Executives the appointments forwarded by the Call Center (Intake) Department. These appointments must be assigned in a balanced fashion.

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F.1.3 Receive, Review and Assign new Agreements. The Credit Counseling Leader Receives new contracts from the Call Center Leader (these agreements are the result from advertisements, recommendations, etc), and distributes them to the Counselors for process and review. After they have been processed by the Account Executives, they are given back to the Counseling Leader who puts them together with the Agreements of the day (result from office appointments and Fax/Internet contracts). All agreements must be reviewed by the Counseling Leader to eliminate potential problems with the information that could result in Debt Management Program service delays. The agreements that need to be corrected will be returned to the assigned Account Executive for correction.

Once all new agreements are assured to be consistent and with accurate information, they will be turned in to the Data Entry Department. The new Debt Management Agreements must be sorted by Payment Due Date.

F.2.- Within the Credit Counseling procedure, the Counseling Account Executives must execute the following:

F.2.1 Give Credit Counseling and Debt Management. When a new prospect is assigned, the Counselor Account Executive is responsible for offering the best Credit Counseling possible via phone, fax or office appointment. In case the prospect client is not physically with the counselor, all conversations (phone, fax, internet) must be highly professional.

REFERENCE: WI-4.1.3.1 STANDARD PHONE GREETING/IN PERSON COUNSELING

The Account Executive is responsible for ensuring that the information contained in the signed Debt Management Agreement is highly accurate, clear and consistent. New Debt Management Agreements must be turned in to the Credit Counseling Leader at the end of the day. Counseling also consists of offering education and budget analysis to prospects. Counselor Account Executives must ensure that our new Clients understand the terms on the Debt Management Program by acknowledging their responsibilities and benefits in participating in the Debt Management Program. “

In the above sections of the procedure for Counseling, there was nothing mentioned in detail about how ORG will train its credit counselors as to how they should counsel the potential client/or clients.

In Quality Procedure Manual QP-4.1.2 and hereby quoted,

“F.2. Invitation and Presentation of attendees

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F.2.1. Clients are contacted utilizing the information in records of the Credit Master Program, starting with the ones that have not attended any course in the past, following with the end that attended once, twice, and so on.

F.2.2. The attendee is informed of the course's topic, schedule, duration and address.

F.2.3. Establish an order for topic presentation and clients are invited making sure that a client is not invited to the same presentation twice.

F.2.4. Compose and maintain, using Microsoft Word, a record to control assistance that must contain:

F.2.4.1. Topic covered

F.2.4.2. Date, time and location of the presentation or course

F.2.4.3. Trainee's name

F.2.5. Presentations will take place every Tuesday, Wednesday and Thursday of each week in the Corporation's Conference room, from 7:00pm to 8:00pm.

To develop the topics of the presentation, Power Point slides are used. The Client will receive copies of such slides.

F.2.6. At the completion of each course, using Power Point, an attendance Diploma will be printed and must contain:

Topic covered

Attendant's name

President's Signature

Trainer's signature

Presentation date

F.2.7. Clients that confirm their assistance and do not attend the presentation will be mailed a letter that states these facts.

REFERENCE: DOC-4.1.2.1 NON-ATTENDANCE LETTER

F.3. Calendar. A calendar of presentations is maintained by the Education Department Leader in Microsoft Outlook to allow the Counseling Department to be informed of presentations and events."

During the initial interview with ORG's President, Secretary and ORG's former Chief Financial Officer, CFO on September 6, 20XX, they indicated ORG had conducted classes to cover basic financial advice. In 20XX, the weekly classes were held on Wednesdays and Thursdays from 7:00pm to 8:30pm. Wednesdays were in English and Thursdays were in

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Spanish. They mentioned at some point in time, ORG had a questionnaire that was given to the class participants for survey so ORG could focus on what kind of problems the participants had. In 20XX, 660 people attended these classes. They indicated 30% of the class participants were ORG's DMP clients and 70% was from the general public. Secretary indicated ORG had sign up sheets for the class participants and they were in storage. She would search for them and provided them to the Internal Revenue Service. As of the date of this report was issued, ORG did not provide any sign-up sheets to verify that the classes did exist.

### **Counseling session:**

During the initial visit to ORG's office on September 6, 20XX, ORG had one walk-in appointment that the agents could sit in and listen. The session lasted for about 50 minutes. In this counseling session, the counselor spent the majority of the time on input of income and expense information onto ORG's software program. The counselor mainly concentrated on asking the individual to contact the creditors for hardship programs and suggested that the individual pay the creditors \$ on each of the accounts that she owed. The counselor did not offer any other alternative except mentioning the credit card company had a hardship program and the individual should continue to make payments as little as \$. The counselor did mention including the individual's name for educational classes. At the end of the session, the counselor asked the individual to call in and make another appointment if the hardship program did not work out.

The agent and another Internal Revenue Service employee who helped to translate the conversation to the agent sat in on a walk-in Spanish speaking appointment on March 4, 20XX. The session lasted approximately 55 minutes. The counselor, again, spent the majority of time on input of the income and expense items onto ORG's software program. The counselor mainly mentioned to the individual to contact his creditors that he had financial problems and was not able to send them the full amount of the payment. She suggested to him that he mention to the creditors that he would send some payments. After adding up the individual's credit card balances, the counselor mentioned to the individual that it would not be easy for him to pay off some of the bills because of his income. However, she could arrange to put him in some hardship classes but she did not mention where these hardship classes took place. The counselor told the individual that she would try to set up an appointment for him to call back to see her and would call him to confirm later in the week.

The Service has asked ORG to provide additional tape recordings for the future counseling sessions. However, ORG indicated either it did not have many calls coming in for initial appointments or the clients did not allow ORG to tape the sessions.

Based on the above counseling sessions, ORG's counselor did not provide education to the individuals by interviewing them about their budget and finances. The counselor did not discuss topics including the individuals' employment, education, buying habits, significant expenditures, and any significant past or anticipated changes in their earnings, assets, expenses and liabilities,

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including the reasons or causes for those changes. The counselor did not develop and present to the individuals a number of options and strategies to address the individuals' debt problems, including creating and maintaining a budget, establishing a debt management payment plans with creditors, and filing for bankruptcy. The counselor did not discuss the advantages and disadvantages of each of these options with the individuals or make recommendations for which options that were best suited to meet the individuals' needs, goals, and circumstances. The counselor provided only one option to the individuals by telling them to pay the minimum of \$ to the creditors and try to contact the creditors' hardship department.

### **Counselor Training:**

During the initial interview with ORG's officers, CFO indicated there was monthly training for the counselors. The areas covered through the training are update creditor changes, customer services, how to approach on what client needs are, income/expense questions, and how to read credit reports. ORG also has weekly meetings. The meetings are concentrated on recent updates on creditors, ways of handling clients' questions, financial needs and helps.

From the interviews with CFO and Secretary, they mentioned that the counselors are AFCPE Certified. The minimum educational requirement for a counselor is high school graduate. The counselors need to study three books and pass an examination through the use of Internet. ORG has a third party to come in to monitor the examination. The counselors started as customer service representatives when they first worked for ORG and then they became counselors.

Upon reviewing the ORG's Quality Procedures Manual (Revision: 12-12-20XX), its Policy Manual and its Employee Handbook (Rev 2 Date 10/12/20XX), there were no discussions as to what a counselor needs to be trained to be a qualified counselor. There was nothing in these manuals indicating what certifications that the counselor needed to achieve before he/she could be considered as a counselor. Also, upon reviewing the employees' personnel records, only one individual, Secretary, ORG's president, was accredited from college.

The Service also reviews some of the meeting notes that ORG conducted in 20XX. On the Weekly Meeting dated June 15, 20XX, one of the items discussed was to focus on bringing in clients. On another Weekly Meeting dated January 4, 20XX, one of the items discussed was hereby quoted,

"We need to have minimum 100 new enrollment clients per month".

Another item discussed on the same day was,

"Any suggestion on how to market our services please give feedback directly to me".



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On one Weekly Meeting dated January 11, 20XX, the meeting was called by EMP-1-ORG's employee; one of the items discussed was and hereby quoted,

"We had 10 total enrolled for year so far first week we had 4 and this week we have 6. All paid enrollment fee with exception of \$ that is pending from \$. The board only had 7 the missing 3 were from and it was explained to her to make sure you put your enrollments on the board."

Another item discussed on the same day was and hereby quoted,

"We need to have minimum 100 new enrollment clients per month; that is 25 per week five per day.

Followed up by letting them know that with what we have, the math won't add up at the end of the month.

....

I closed the meeting with everyone standing up and we all gave the new ORG Motivational Cheer and one more thing let me know you liked the meeting and lets go get a minimum 100 clients.

...."

From the Weekly Meeting agenda, there were no discussions on how to train a counselor to educate his/her clients for their financial needs. The discussions in the Weekly Meeting were concentrated on procedures to manage the DMP accounts and how to enroll more clients in order to meet the goal of 100 clients per month.

#### **Employee evaluations:**

Upon reviewing nine employee personnel files (current and former employees), only one employee had an Employee Performance Review dated on February 26, 20XX. That employee's position was Receptionist. ORG had not provided any employee evaluations on the counselors.

#### **Number of clients:**

In ORG's response to the Service's initial request (IDR#1), ORG provided a one-page data showing in 20XX, ORG's total number of clients was 1,745. The number of new enrollees was 660 and the number of clients dropped was 935. It was noted that this data was inconsistent with the number of clients enrolled as provided subsequently in April 20XX.

#### **Fees Charged:**



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From the initial interview, the initial set up fee for a DMP is \$ and the monthly service fees from clients are varied from \$ up to a maximum of \$ per state requirement. The initial set up fee cannot be waived. The monthly fee can be waived at the client's request.

**Advertising:**

From the initial interview, CFO and Secretary mentioned that ORG advertised its services through newspapers and radio. However, ORG has not done any advertising for the past two years due to the high cost of advertising. ORG's clients were either through advertisement or through word of mouth. When asked whether ORG purchased any leads, CFO indicated that in 20XX, ORG did use \$ to purchase some leads but they turned out to be unreliable leads. ORG also posted flyers at stores nearby to advertise its programs.

ORG also has a website, but only gets a few responses from questions or requests information regarding ORG's services. ORG did not keep track of who accessed the site. CFO mentioned that the website has not been an effective tool to bring in new clients.

When the agents asked for the sample of the clients' files for the notes to record the conversations between the clients and the counselor, it was noted that some of the clients' files did have different lead numbers written on the "Client's General Information and Budget Disclosure" form.

**Financial Data:**

**Form 990:**

ORG has filed Form 990PF, Return of Private Foundation or Section 4947(a)(1) Nonexempt Charitable Trust Treated as a Private Foundation for both 20XX and 20XX years.

**Revenue:**

For the years under examination, ORG received its funding from the following:

Category	20XX	20XX
interest		
dividends		
loss on sale of assets		
Client fees		
Fair Share		
Other income-sale of assets		
Total		

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**Expenses:**

For the years under examination, ORG incurred the following expenses:

Category	20XX	%	20XX	%
Advertising				
Salaries/Wages				
Printing Expenses				
Postage/Delivery				
Education seminars				
Others				
Total				

**Net income/or net loss for the years was:**

Net Loss	20XX	20XX

**Balance Sheet:**

From ORG's Form 990PF for the two years, ORG had the following assets listed:

Category	20XX	20XX
Cash-noninterest bearing		
Savings/temp cash investment		
Notes receivable		
Prepaid expense		
Land/building		
Other assets		
Total assets		
Other Liability		
Total Liability		

**Bank Statements:**

ORG maintained the following accounts as of the end of each tax year under examination. The account balances shown on the bank and brokerage statements for these accounts were as follows:

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Account	Account Number	Type	Balance as of 12/31	Balance as of 12/31
Bank-1		Administrative Acct		
Bank-1		Administrative Acct		
Bank-1		Trust Account		
Bank-2		Administrative Acct		

The Service has requested for the financial data for the 20XX year. However, as of the date of this report, ORG has not provided the information for the 20XX year.

**Unsubstantiated expenses:**

Upon reviewing the general ledger provided by ORG, the following expenses were incurred for the benefit of the named individuals. Since ORG did not provide any backup supporting documents for the expenses incurred, the expenses are treated as automatic excess benefit transactions under Internal Revenue Code Section 4958 to the named individuals. Please see separate Revenue Agent Report for the following breakdown of each expense:

For	Year	Auto payments	Life Insurance	American Exp	Note Receivable	Consultant Fee
Secretary	20XX					
	20XX					
CFO	20XX					

**Auto leasing, life insurance and note receivable for Secretary:**

**20XX year:**

For the 20XX year, ORG paid for Secretary's automobile for a total of \$ (\$for eight months paid directly to Secretary and \$for eleven months paid to CO-1. The statement from CO-1 was addressed to Secretary. ORG did not provide any supporting documents to substantiate the auto expenses as a legitimate business expense for ORG's operation.

In 20XX year, ORG paid a total of \$ (Check Number and) to CO-2 for Secretary's life insurance. ORG did not provide any supporting documents to substantiate the reason for the life insurance expense.

On ORG's balance sheet as of 12/31/20XX, Secretary owed ORG a total amount of \$ which was reported on ORG's Form 990 as Notes Receivable. However, no documentation was provided to show that this amount was actually a loan from ORG to Secretary.

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**20XX year:**

For the 20XX year, ORG paid a total of \$ to CO-1. As mentioned above, the statement from CO-1 was addressed to Secretary. ORG did not provide any supporting documents to substantiate the auto expenses as needed for ORG's exempt function. Therefore, the payments are subject to Automatic Excess Benefit Transactions. Please see separate report.

In 20XX year, ORG paid a total of \$ to CO-2 for Secretary's life insurance. Again, ORG did not provide any supporting documents to substantiate the reason for purchasing life insurance for Secretary. Therefore, the payments are subject to Automatic Excess Benefit Transactions. Please see separate report.

**Office Rents to Secretary:**

**20XX year:**

ORG paid a total of \$ office rental to Trust. The total rental square footage to ORG was \$. The monthly rental fee was \$ which included a base rent of \$ operating expense of \$ and \$ for the parking. When asked for the appraisal report as to how the rental amount was determined, ORG did not provide any appraisal report. The Service has not made any determination whether the office rents paid to Trust constitute any excess benefit transaction.

**20XX year:**

Again, ORG paid a total of \$ office rental to Trust. The Service has not made any determination whether the office rents paid to Trust constitute any excess benefit transaction.

**Consultant fee of \$ paid to Secretary in 20XX year:**

In 20XX year, ORG paid a total of \$ to Secretary. According to the minutes dated May 31, 20XX, it indicated Secretary was hired as a consultant at a rate of \$ per month to provide services for ORG as directed by the President of ORG. This minutes constitutes a self serving document because as mentioned in the early sections (Minutes and ORG's officers and directors) of this report, the title of "President" has been exchanged between CFO and Secretary a few times from 20XX through 20XX years. They were the individuals who run the daily operations of ORG. When asked for the employment contract for Secretary, ORG on its response dated March 9, 20XX indicating and hereby quoted,

"There is no contract with Secretary because she is the President of the company."

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Therefore, the \$ payments to Secretary should be treated as wages to her and not as consultant fee. Please see attached employment tax report showing this amount was treated as wages to Secretary.

**CO-3 charges for travel related and entertainment expenses:**

In 20XX, ORG paid a total of \$ expenses on gas and repair, entertainment, travel and transportation, lodging and meals. When asked for the backup documents to substantiate the expenses incurred, ORG only provided three months' statements from CO-3 showing the charges incurred by Secretary. Since the charges were made by Secretary and no written substantiation was provided for them, the Service treats these transactions as Automatic Excess Benefit Transactions. Please see separate Revenue Agent Report for these expenses.

In 20XX, ORG paid a total of \$ expenses on gas and repair, entertainment, travel and transportation. When asked for the backup documents to substantiate the expenses incurred, ORG was unable to provide any documents to substantiate the expenses. Since Secretary is the only person who has access to the credit card of ORG, the Service treats these expenses as Automatic Excess Benefit Transactions to Secretary. Please see separate Revenue Agent Report for these expenses.

**Auto payments to CFO in 20XX year:**

ORG paid a total of \$ directly to CFO in the 20XX year for car leasing. However, ORG did not provide any supporting documents to substantiate the expense. The Service treats this expense as Automatic Excess Benefit Transactions to CFO. Please see attached separate report for these payments.

**Lack of cooperation for the examination process from ORG:**

The Service has been requesting additional information such as bank statements, automobile loan documents, scripts used by ORG's employees in contacting clients, and back up documentation to substantiate charges made on the CO-3 credit card. The officer, Secretary has been avoiding the agent. The agent left a few voice messages to Secretary but was never heard back from her. The only documentation that the agent received was from ORG's receptionist, EMP-2 and ORG's bookkeeper, CFO-1. Based on what the Agent has available for records on ORG, the Agent has to issue this report in order to protect the Government's interest.

**LAW:**

Section 501(a) of the Internal Revenue Code provides that an organization described in section 501(c)(3) is exempt from income tax. Section 501(c)(3) of the Code exempts from federal income tax corporations organized and operated exclusively for charitable, educational,

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and other purposes, provided that no part of the net earnings inure to the benefit of any private shareholder or individual. The term charitable includes relief of the poor and distressed. Section 1.501(c)(3)-1(d)(2), Income Tax Regulations.

The term educational includes (a) instruction or training of the individual for the purpose of improving or developing his capabilities and (b) instruction of the public on subjects useful to the individual and beneficial to the community. Treas. Reg. § 1.501(c)(3)-1(d)(3). In other words, the two components of education are public education and individual training.

Section 1.501(c)(3)-1(a)(1) of the regulations provides that, in order to be exempt as an organization described in section 501(c)(3), an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will be regarded as “operated exclusively” for one or more exempt purposes only if it engages primarily in activities that accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose. The existence of a substantial nonexempt purpose, regardless of the number or importance of exempt purposes, will cause failure of the operational test. Better Business Bureau of Washington, D.C. v. U.S., 326 U.S. 279 (1945).

Educational purposes include instruction or training of the individual for the purpose of improving or developing his capabilities and instruction of the public on useful and beneficial subjects. Treas. Reg. § 1.501(c)(3)-1(d)(3). In Better Business Bureau of Washington D.C., Inc. v. United States, 326 U.S. 279 (1945), the Supreme Court held that the presence of a single non-exempt purposes, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes. The Court found that the trade association had an “underlying commercial motive” that distinguished its educational program from that carried out by a university.

In American Institute for Economic Research v. United States, 302 F. 2d 934 (Ct. Cl. 1962), the Court considered the status of an organization that provided analyses of securities and industries and of the economic climate in general. The organization sold subscriptions to various periodicals and services providing advice for purchases of individual securities. Although the court noted that education is a broad concept, and assumed for the sake of argument that the organization had an educational purpose, it held that the organization had a significant non-exempt commercial purpose that was not incidental to the educational purpose and was not entitled to be regarded as exempt.

An organization must establish that it serves a public rather than a private interest and “that it is not organized or operated for the benefit of private interests such as designated individuals, the



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creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.” Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii). Prohibited private interests include those of unrelated third parties as well as insiders. Christian Stewardship Assistance, Inc. v. Commissioner, 70 T.C. 1037 (1978); American Campaign Academy v. Commissioner, 92 T.C. 1053 (1989). Private benefits include an “advantage; profit; fruit; privilege; gain; [or] interest.” Retired Teachers Legal Fund v. Commissioner, 78 T.C. 280, 286 (1982).

An organization formed to educate people in Hawaii in the theory and practice of “est” was determined by the Tax Court to a part of a “franchise system which is operated for private benefit,” and, therefore, should not be recognized as exempt under section 501(c)(3) of the Code. est of Hawaii v. Commissioner, 71 T.C. 1067, 1080 (1979). Although the organization was not formally controlled by the same individuals who controlled the for-profit entity that owned the license to the “est” body of knowledge, publications, and methods, the for-profit entity exerted considerable control over the applicant’s activities by setting pricing, the number and frequency of different kinds of seminars and training, and providing the trainers and management personnel who are responsible to it in addition to setting price for the training. The court stated that the fact that the organization’s rights were dependent upon its tax-exempt status showed the likelihood that the for-profit entities were trading on that status. The question for the court was not whether the payments made to the for-profit were excessive, but whether the for-profit entity benefited substantially from the operation of the organization. The court determined that there was a substantial private benefit because the organization “was simply the instrument to subsidize the for-profit corporations and not vice versa and had no life independent of those corporations.”

The Service has issued two rulings holding credit counseling organizations to be tax exempt. Rev. Rul. 65-299, 1965-2 C.B. 165, granted exemption to a 501(c)(4) organization whose purpose was to assist families and individuals with financial problems and to help reduce the incidence of personal bankruptcy. Its primary activity appears to have been meeting with people in financial difficulties to “analyze the specific problems involved and counsel on the payment of their debts.” The organization also advised applicants on proration and payment of debts, negotiated with creditors and set up debt repayment plans. It did not restrict its services to the needy. It made no charge for the counseling services, indicating they were separate from the debt repayment arrangements. It made “a nominal charge” for monthly prorating services to cover postage and supplies. For financial support, it relied upon voluntary contributions from local businesses, lending agencies, and labor unions.

Rev. Rul. 69-441, 1969-2 C.B. 115, granted 501(c)(3) status to an organization with two functions: it educated the public on personal money management, using films, speakers, and publications, and provided individual counseling to “low-income individuals and families.” As part of its counseling, it established budget plans, i.e., debt management plans, for some of its clients. The debt management services were provided without charge. The organization was supported by contributions primarily from creditors. By virtue of aiding low income people,



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without charge, as well as providing education to the public, the organization qualified for section 501(c)(3) status.

In the case of Consumer Credit Counseling Service of Alabama, Inc. v. U.S., 44 A.F.T.R.2d 78-5052 (D.D.C. 1978), the District Court for the District of Columbia held that a credit counseling organization qualified as charitable and educational under section 501(c)(3). It fulfilled charitable purposes by educating the public on subjects useful to the individual and beneficial to the community. Treas. Reg. § 1.501(c)(3)-1(d)(3)(i)(b). For this, it charged no fee. The court found that the counseling programs were also educational and charitable; the debt management and creditor intercession activities were “an integral part” of the agencies’ counseling function and thus were charitable and educational. Even if this were not the case, the court viewed the debt management and creditor intercession activities as incidental to the agencies’ principal functions, as only approximately 12 percent of the counselors’ time was applied to debt management programs and the charge for the service was “nominal.” The court also considered the facts that the agency was publicly supported and that it had a board dominated by members of the general public as factors indicating a charitable operation. See also, Credit Counseling Centers of Oklahoma, Inc. v. United States, 79-2 U.S.T.C. 9468 (D.D.C. 1979), in which the facts and legal analysis were virtually identical to those in Consumer Credit Counseling Centers of Alabama, Inc. v. United States, discussed immediately above.

The organizations included in the above decision waived the monthly fees when the payments would work a financial hardship. The professional counselors employed by the organizations spent about 88 percent of their time in activities such as information dissemination and counseling assistance rather than those connected with the debt management programs. The primary sources of revenue for these organizations were provided by government and private foundation grants, contributions, and assistance from labor agencies and United Way.

Outside the context of credit counseling, individual counseling has, in a number of instances, been held to be a tax-exempt charitable activity. Rev. Rul. 78-99, 1978-1 C.B. 152 (free individual and group counseling of widows); Rev. Rul. 76-205, 1976-1 C.B. 154 (free counseling and English instruction for immigrants); Rev. Rul. 73-569, 1973-2 C.B. 179 (free counseling to pregnant women); Rev. Rul. 70-590, 1970-2 C.B. 116 (clinic to help users of mind-altering drugs); Rev. Rul. 70-640, 1970-2 C.B. 117 (free marriage counseling); Rev. Rul. 68-71, 1968-1 C.B.249 (career planning education through free vocational counseling and publications sold at a nominal charge). Overwhelmingly, the counseling activities described in these rulings were provided free, and the organizations were supported by contributions from the public.

Internal Revenue Code section 501(c)(3) specifies that an exempt organization described therein is one in which “no part of the net of earnings inures to the benefit of any private shareholder or individual.” The words “private shareholder or individual” in section 501 to refer to persons having a personal and private interest in the activities of the organization. Treas. Reg. Section 1.501(a)-1(c). The inurement prohibition provision “is designed to prevent the siphoning

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of charitable receipts to insiders of the charity..." United Cancer Council v. Commissioner, 165 F.3d 1173 (7<sup>th</sup> Cir. 1999). Reasonable compensation does not constitute inurement. Birmingham Business College v. Commissioner, 276 F.2d 476, 480 (5<sup>th</sup> Cir. 1960).

Internal Revenue Code section 4942(j)(3) defines the term "operating foundation" as any organization

(A) which makes qualifying distributions (within the meaning of paragraph (1) or (2) of subsection (g) directly for the active conduct of the activities constituting the purpose or function for which it is organized and operated equal to substantially all of the lesser of (i) its adjusted net income (as defined in subsection (f)), or (ii) its minimum investment return; and

(B)(i) substantially more than half of the assets of which are devoted directly to such activities or to functionally related businesses (as defined in paragraph (4)), or to both, or are stock of a corporation which is controlled by the foundation and substantially all of the assets of which are so devoted,

(ii) which normally makes qualifying distributions (within the meaning of paragraph (1) or (2) of subsection (g)) directly for the active conduct of the activities constituting the purpose or function for which it is organized and operated in an amount not less than two-thirds of its minimum investment return (as defined in subsection (e)) or,

(iii) substantially all of the support (other than gross investment income as defined in section 509(e)) of which is normally received from the general public and from 5 or more exempt organizations which are not described in section 4946(a)(1)(H) with respect to each other or the recipient foundation; not more than 25 percent of the support (other than gross investment income) of which is normally received from any one such exempt organization; and not more than half of the support of which is normally received from gross investment income.

Notwithstanding the provisions of subparagraph (A), if the qualifying distributions (within the meaning of paragraph (1) or (2) of subsection (g)) of an organization for the taxable year exceed the minimum investment return for the taxable year, clause (ii) of subparagraph (A) shall not apply unless substantially all of such qualifying distributions are made directly for the active conduct of the activities constituting the purpose or function for which it is organized and operated.

Internal Revenue Code section 4942(g)(1) defines "Qualifying distributions" as,

(A) any amount (including that portion of reasonable and necessary administrative expenses) paid to accomplish one or more purposes described in section 170(c)(2)(B), other than any contribution to (i) an organization controlled (directly or indirectly) by the foundation or one or more disqualified persons (as defined in section 4946) with respect to the foundation, except as

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provided in paragraph (3), or (ii) a private foundation which is not an operating foundation (as defined in subsection (j)(3)), except as provided in paragraph (3), or  
(B) any amount paid to acquire an asset used (or held for use) directly in carrying out one or more purposes described in section 170(c)(2)(B).

**Taxpayer's Position:**

ORG's position has not been determined.

**Government's Position:**

The Service contends that ORG has a more than insubstantial nonexempt purpose. ORG provides its DMP service as the only activity. Therefore, its exemption status should be revoked.

ORG's total funding was from fair share contributions and monthly service fees. ORG did not receive any private or governmental grants for the years under examination. ORG had completely relied on creditors' fair share and clients' fees for its operation.

During the initial interview with Secretary and CFO, they both indicated that ORG had conducted classes to cover basic financial advice. However, ORG had never provided any documentation to prove that it did conduct educational classes for the years under examination. ORG emphasizes its debt management program by indicating on its website that it will reduce or eliminate interest rates and over the limit and late fees, stop creditor calls, lower monthly payments and make low monthly payments. ORG's website provided three educational books called Financial Education, Introduction; Financial Tips; and Work Book. ORG's website does not provide any educational class schedule to show any ongoing classes that are held currently.

ORG does not have a community based board. From the minutes that ORG provided for 20XX through 20XX years, ORG's directors had reduced from four individuals to two individuals. As for officers, ORG had three individuals for these years. The minutes appeared to be self serving. Secretary and CFO had been exchanging their positions as president of ORG back and forth throughout these three years. In 20XX, Secretary was resigned as president and in 20XX, she became ORG's president again. Also, in the minutes, Secretary and CFO were given car allowances and specific amount of compensation. However, no detailed documentation was provided as to how the compensation amounts and the car allowances were determined. In addition, the minutes never discussed how ORG's credit counseling activities were operated.

Upon reviewing the former and current employees personnel files, ORG had only one individual, Secretary, was certified through college. The rest of ORG's employees did not hold any certification. In addition, only one employee had an employee performance review prior to 20XX and 20XX years. The rest of the employees had no performance evaluations.

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**Conclusion:**

In summary, ORG was not operated exclusively for exempt purposes, because it did not engage primarily in activities that accomplish an exempt purpose, more than an insubstantial part of ORG's activities are in furtherance of a non-exempt purpose. ORG was operated as if it is a for-profit entity by providing debt management program service. Accordingly, it is determined that ORG is not an organization described in section 501(c)(3), and is not exempt from income tax under section 501, effective January 1, 20XX.